No. 76-1263

In the Supreme Court of the United States

OCTOBER TERM, 1976

THE FIRST NATIONAL BANK OF CHICAGO, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

WADE H. MCCREE, JR.,
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The question presented in this federal income tax case is whether petitioner, a national bank, can deduct $459,283.07 as an addition to its bad debt reserve for 1968.

Section 166(c) of the Internal Revenue Code of 1954 (26 U.S.C.) permits taxpayers to deduct, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts. Petitioner elected to compute this deduction under the uniform reserve ratio prescribed by Rev. Rul. 65-92, 1965-1 Cum. Bull. 112, which generally allows a bank to deduct additions to its bad debt reserve until the reserve equals 2.4 percent of the loans outstanding at the end of the taxable year. The prerequisites for inclusion of an item or amount in a bank's loan base were clarified in Rev. Rul. 68-630, 1968-2 Cum. Bull. 84, which excluded, *inter alia*, "loans

* * * not representative of the bank's ordinary portfolio of outstanding customer loans." Section 9, Rev. Rul. 68-630, *supra.*

In computing its outstanding loan base for 1968, petitioner included $19,136,794.50 of advances to its own trust department.[1] The Commissioner excluded these advances from petitioner's loan base because they were "not representative of the bank's ordinary portfolio of outstanding customer loans" as Section 9 of Rev. Rul. 68-630, *supra,* required. The Tax Court ruled that the advances were includable in petitioner's loan base (Pet. App. A-1 to A-14). The court of appeals reversed. It held that the Commissioner reasonably determined, within his discretion, that petitioner could not enlarge its bad debt reserve to cover its trust department advances because those advances were not typical examples of its outstanding loans (Pet. App. A-15 to A-24).[2]

1. The court of appeals correctly held that the Commissioner did not abuse his discretion in excluding the trust department advances from petitioner's loan base for purposes of computing its allowable bad-debt reserve. This decision is consistent with those of other appellate

[1]Petitioner's advances to its trust department arose because the trust department made cash disbursements on behalf of trust accounts which temporarily had insufficient cash to cover the disbursements. The advances were authorized when the trust department officer was reasonably certain that the advance would be repaid (Pet. App. A-15 to A-16).

[2]The question presented has little administrative importance. For taxable years beginning after July 11, 1969, Section 585(b)(4) of the Code requires the Commissioner to promulgate regulations defining loans eligible for inclusion in the loan base. As the court of appeals noted (Pet. App. A-22 to A-23), petitioner's advances to its trust department would not qualify for inclusion in its loan base under the proposed regulations.

courts holding that the Commissioner's determination with respect to the computation of a bad-debt reserve must be sustained unless it is "unreasonable," or an abuse of his discretion. See, *e.g., Akron National Bank & Trust Co.* v. *United States,* 510 F. 2d 1157 (C.A. 6); *Merchants Industiral Bank* v. *Commissioner,* 475 F. 2d 1063 (C.A. 10); *American State Bank* v. *United States,* 279 F. 2d 585 (C.A. 7), certiorari denied, 364 U.S. 891; and *Paramount Finance Co.* v. *United States,* 304 F. 2d 460 (Ct. Cl.).

Here, the court observed that petitioner's advances to its trust department for temporary advances on behalf of trust accounts were not includable in its loan base because the commercial loan department did not receive any notes or charge any interest for the advances to its trust department, did not impose any maturity dates or repayment schedules, and suffered only *de minimis* losses. Moreover, the advances were not evaluated by petitioner's commercial loan officers (Pet. App. A-20 to A-21). Under these circumstances, the court of appeals properly concluded that petitioner's trust department advances represented no risk and were not representative of its ordinary portfolio of outstanding customer loans, and that the Commissioner properly excluded them from the loan base.[3]

2. As the court of appeals recognized (Pet. App. A-19 to A-20), its decision does not conflict with *State Bank of Albany* v. *United States,* 530 F. 2d 1379 (Ct. Cl.), and *North Carolina National Bank* v. *United States,* 345 F. 2d 544 (Ct.

[3]Moreover, petitioner's reliance on Section 4 of Rev. Rul. 68-630, *supra,* which specifies that "an overdraft in one or more deposit accounts of a customer is an outstanding loan eligible for inclusion in the loan base," is misplaced. As the court of appeals noted (Pet. App. A-23), petitioner's trust department advances are not overdrafts in deposit accounts.

Cl.), or with *Pullman Trust & Savings Bank* v. *United States,* 338 F. 2d 666 (C.A. 7), affirming 235 F. Supp. 317 (N.D. Ill.). *State Bank of Albany* and *North Carolina National Bank* involved the interpretation of the now-superseded Mim. 6209, 1947-2 Cum. Bull. 26,[4] which authorized banks to compute annual additions to their bad debt reserves by reference to an average experience factor representing the ratio of losses to loans over a 20-year period. But the question presented in those decisions involved the inclusion of state and local government notes in the taxpayer's loan base and not the particular intra-bank advances of the type at issue here. While the Court of Claims held that Mim. 6209 was analogous to a contract so that an ambiguity in Mim. 6209 must be resolved against the Commissioner, there is no ambiguity in Rev. Rul. 68-630, the operative ruling in this case. As the court of appeals observed (Pet. App. A-19), the plain meaning of Section 9 of that ruling requires the exclusion of petitioner's trust department advances from its loan base.[5]

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

WADE H. MCCREE, JR.,
Solicitor General.

APRIL 1977.

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[4]Mim. 6209 was superseded by Rev. Rul. 65-92, *supra,* which in turn was amplified by Rev. Rul. 68-630, *supra.*

[5]*Pullman Trust & Savings Bank* v. *United States, supra,* is likewise distinguishable. There, the court held that the Commissioner had properly exercised his discretion in promulgating Mim. 6209, and that a taxpayer's computation in accordance with that ruling was presumed to be reasonable (235 F. Supp. at 323). The decision did not address the includability of the trust department advances involved here.